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SIPDIS

USDOC FOR 4212/ITA/MAC/CPD/DDEFALCO  
USDOE FOR CHARLES WASHINGTON  
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SENSITIVE

E.O. 12958: N/A

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SUBJECT: TURKEY SETS PRIVATIZATION MODEL FOR  
ELECTRICITY DISTRIBUTION

Ref: Ankara 492

Sensitive But Unclassified. Please handle accordingly.

11. (SBU) Summary: Aiming to expedite delayed privatization of Turkey's electricity distribution network (in which at least one U.S. company has expressed strong interest), the GOT has decided to move forward based on a "transfer-of-operating-rights" (TOR) sale of shares model, rather than through a direct sale of the underlying physical assets. The motivation is to avoid legal challenges on constitutional "national interest" grounds in order to implement privatization in the shortest time possible. The Energy Market Regulatory Authority (EMRA) is however concerned that some last-minute provisions added to the Electricity Market law may undermine its independence and hamper market liberalization. End Summary.

#### The Privatization Model

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12. (U) Ending long discussions regarding the model of privatization for the electricity distribution network, the GOT decided on March 25 to pursue a "Transfer-of-Operating Rights" (TOR)-backed share sale model. The Privatization Administration has long argued for the TOR model, as opposed to a direct asset sale approach in order to minimize potential legal challenges and expedite the privatization process (Reftel). The GOT has identified 20 distribution regions and has established associated companies with electricity distribution licenses and operating rights. Potential buyers will bid for the shares of these companies and take over operating rights for distribution regions for 30- 49 years. The investors will also take over any assets (i.e. land, building, vehicles, etc.) owned by the companies, but the government will retain distribution infrastructure ownership.

13. (SBU) In a telephone conversation with Econoff on March 31, Ministry of Energy and Natural Resources (MENR) Energy Affairs DG Budak Dilli confirmed the GOT's decision to rule out the asset sale model and move forward with the TOR-backed share sale model. Dilli acknowledged the delay in the March 31, 2005 deadline set by the Energy Strategy Paper for announcement of the tender, but said this was a reasonable delay, given the size and importance of the operation. Finance Minister Kemal Unakitan announced on March 31 that the GOT had sent an amendment to the Electricity Market Law to the Prime Ministry, aiming to facilitate privatization.

#### Privatize at the Cost of Liberalization?

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14. (SBU) Despite the GOT decision, EMRA Electricity Regulation Department Head Murat Erenel raised concerns to Econoff and Econ Specialist on April 7 about developments in the electricity distribution privatizations. Erenel said EMRA generally supported recent amendments proposed by the GOT to the Electricity Market Law, which aimed to expedite privatization. The amendments would provide for a set transitional price mechanism for distributors in the five years following privatization. However, Erenel heard from MENR sources that the GOT made additional changes to the amendment, subsequent to EMRA's approval, which, according to Erenel, would pose a serious threat to market liberalization.

15. (SBU) Elaborating on these troublesome amendments, Erenel first cited Article 3 of the current Electricity Market Law, which enables distribution companies to establish generation facilities in their region, but

sets a limit to the amount purchased from these facilities. According to the law, distribution companies cannot buy from these vertically-integrated facilities more than 20 percent of the electricity consumed in the region during the previous year. Erenel learned that the GOT was planning to lift this cap for companies, ostensibly in order to make distribution networks more attractive to investors. This change would potentially endanger fragile competition in the market, according to Erenel, allowing creation of new oligopolies. Moreover, Erenel noted the lack of a provision preventing company mergers in the newest draft legislation, which he believed would open the way to monopolies.

16. (SBU) The GOT reportedly made an additional last-minute amendment to Article 6 of the draft Electricity Market Law, which authorized EMRA to set the amount of electricity the State Generation Company (EUAS) could sell to the State Trading Company (TETAS) in the five-year transition period. While the original intent of the article was to reduce the state's share in energy generation in a liberalized market, the latest version reportedly would transfer some of EMRA's authority to MENR, as well as doing away with the limitation. Erenel said such a change would grant the government unlimited authority to make new state investments - "in order to maintain the security of supply," which would create a major threat to both market liberalization and potential private investments in the sector.

17. (SBU) CONTINUING IN THIS VEIN, ERENEL COMPLAINED THAT THESE AMENDMENTS FORMED PART OF THE GOT'S SYSTEMATIC ATTACK ON INDEPENDENT AUTHORITIES. THE SEPARATE DRAFT LAW ON INDEPENDENT BOARDS CURRENTLY AT THE PRIME MINISTRY WOULD PROMULGATE SERIOUS LIMITATIONS TO INDEPENDENT BOARDS' ACTIONS AND AUTHORITY, ACCORDING TO ERENEL, BASICALLY REDUCING THEIR ROLE TO AGENCIES REPORTING TO THE GOVERNMENT. ERENEL CLAIMED THAT DESPITE HOLDING A SIGNIFICANT MAJORITY, THE CURRENT GOVERNMENT HAD STALLED MARKET LIBERALIZATION EFFORTS, LAUNCHED BY THE PREVIOUS GOVERNMENT, EVEN THOUGH IT HAD BEEN A WEAKER, COALITION GOVERNMENT.

COMMENT  
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18. (SBU) THE GOT'S EFFORTS TO MOVE FORWARD WITH ELECTRICITY DISTRIBUTION PRIVATIZATIONS IS A STEP IN THE RIGHT DIRECTION. IMPLEMENTING A TOR BASED MODEL SEEMS TO BE A REASONABLE DECISION, TAKING INTO ACCOUNT PROSPECTIVE INVESTORS' FEEDBACK. THIS METHOD WOULD REDUCE RISKS OF JUDICIAL CHALLENGE AND MINIMIZE COST OF INVESTMENT TO ATTRACT MORE INVESTORS, COMPARED TO THE ASSET SALE MODEL. HOWEVER, THE GOT'S APPARENT DESIRE TO UNDERMINE THE POWER OF THE INDEPENDENT REGULATORS, WHICH WE ALSO HEAR FROM THE TELECOM BOARD AND OTHER AGENCIES, IS A MATTER OF GREAT CONCERN AND COULD POSE A SIGNIFICANT THREAT TO TURKEY'S INVESTMENT ENVIRONMENT. MOREOVER, TURKEY'S PERIODIC AND ARBITRARY CHANGES IN PRIVATIZATION APPROACH OVER THE PAST TWENTY YEARS LEAVE A LEGACY OF AN ALPHABET SOUP OF FAILED MODELS AND LEGAL CHALLENGES AND AMBIGUITIES, SOME OF WHICH INCLUDED PREVIOUS UNSUCCESSFUL TOR PROJECTS. END COMMENT.

Edelman